Joint Committee on Taxation
September 23, 1991
JCX-17-91

COMMITTEE ON WAYS AND MEANS MARKUP ON SEPTEMBER 25, 1991 OF THE FINANCIAL INSTITUTIONS SAFETY AND CONSUMER CHOICE ACT OF 1991 (H.R. 6)

H.R. 6, The Financial Institutions Safety and Consumer Choice Act of 1991 (generally referred to as the Bank Reform Bill), was reported to the full House of Representatives on July 23, 1991, with amendments, by the House Committee on Banking, Finance and Urban Affairs (H. Rept. 102-157, Part 1). The bill was sequentially referred to the Committee on Ways and Means for a period ending September 27, 1991, and also was sequentially referred to the Committee on Energy and Commerce, the Committee on the Judiciary and the Committee on Agriculture (also through September 27, 1991).

I. PUBLIC DEBT ISSUES

Present Law

The Federal Deposit Insurance Corporation (FDIC) has the ability to borrow amounts from the Federal Treasury for depository insurance purposes in amounts not exceeding $5 billion. In addition, the FDIC may issue obligations for depository insurance purposes, including borrowing from the Federal Treasury through the Federal Financing Bank, but no obligation may be issued or liability incurred under any guarantee or similar obligation if the net worth of the Bank Insurance Fund or the Savings Association Insurance Fund would be less than 10 percent of its assets.

Description of Bank Reform Bill (H.R. 6)

Under H.R. 6, the FDIC would be authorized to borrow under three methods. First, the FDIC could borrow amounts up to $30 billion from the Federal Treasury. In addition, the FDIC would be authorized to incur further obligations, including borrowing from the Treasury Department through the Federal Financing Bank, but the total amount of outstanding obligations of the Bank Insurance Fund or the Savings Association Insurance Fund could not exceed the sum of (1) the amount of cash or cash equivalents held by the respective depository insurance fund, (2) 90 percent of the FDIC's

estimate of the fair market value of assets held in the respective depository insurance fund, and (3) the $30 billion authorized to be borrowed from the Treasury. Further, H.R. 6 would allow the FDIC to borrow from banks which are members of the Bank Insurance Fund, at rates of interest determined by the FDIC. Banks could make such investments only from the bank's capital or retained earnings, and such obligations held by a bank would count as assets for purposes of determining compliance with capital standards. Treasury Department borrowing on behalf of the FDIC would be counted as a public debt transaction, but FDIC borrowing directly from banks would not be counted as a public debt transaction.

Possible Option

Under the possible option, the provision allowing the FDIC to borrow additional amounts from banks that are members of the Bank Insurance Fund would be modified so that (1) the amount of such borrowing would count against the $30 billion limit on borrowing from the Treasury, (2) the interest rates that the FDIC could pay on the obligations would be no greater than current market yields on obligations of the United States of comparable maturities, (3) the issuance of such obligations would be a public debt transaction, and therefore subject to the public debt limit, and (4) banks holding such obligations could only transfer such obligations to other banks that are members of the Bank Insurance Fund.

II. TAX PROVISIONS

Present Law of Relevant Federal Banking Rules

Under the Bank Holding Company Act of 1956, a bank holding company is any company that directly or indirectly controls a bank. In addition, the Bank Holding Company Act sets forth limits on the nonbanking activities that can be conducted by a holding company or its nonbanking subsidiaries. Accordingly, the principal permissible activity of a bank holding company is controlling and managing its subsidiary banks. As a consequence of these rules, a bank generally can be owned only directly by individuals or by a holding company which is owned by individuals and whose principal holdings are banks (or other bank holding companies).

Description of Bank Reform Bill (H.R. 6)

Modification to rules for bank holding companies (bill secs. 409 and 691).-- The Bank Reform Bill, as reported by the Committee of Banking, Finance and Urban Affairs, makes two basic structural changes to how banks can be owned and operated. First, the bill would allow banks to be indirectly held by a commercial company (e.g., a manufacturing

corporation which itself would be known as a "diversified holding company") through ownership of a new type of bank holding company, to be known as a "financial services holding company." Second, the bill would expand the permissible nonbanking activities in which the newly-named financial services holding company may engage through its subsidiaries to include certain securities activities, including the activities of a broker/dealer, investment banker, and financial advisor to mutual funds.

The Bank Reform Bill redesignates the Bank Holding Company Act of 1956 as the "Diversified and Financial Services Holding Company Act of 1991" and provides that any reference in Federal law to the Bank Holding Company Act shall be deemed a reference to the newly redesignated act. The Bill also provides that "any reference in any Federal law to a bank holding company shall be deemed to be a reference to a financial services holding company."

Study of tax treatment of various types of savings associations (bill sec. 631(c)(2)(D)).--The Bank Reform Bill establishes a new commission, to be known as the Commission on the Thrift Industry. One of its functions is to study and make reports on specified topics to the President, the House Committee on Banking, Finance and Urban Affairs, and the Senate Committee on Banking, Housing and Urban Affairs. One of the topics for which studies is required is the "tax treatment of the various types of savings associations."

Present Law of Relevant Federal Tax Rules

The Internal Revenue Code contains three provisions, described below, which apply to bank holding companies and which cross refer to the Bank Holding Company Act.

Dividends received deduction (Code sec. 246A)

Corporations generally may deduct an amount equal to 70 percent of dividends received from other domestic corporations (100 percent in the case of certain dividends from affiliated corporations) if they satisfy certain holding period requirements. The dividends received deduction is reduced, however, if portfolio stock is debt financed. Stock is considered portfolio stock unless (1) the taxpayer owns at least 50 percent of the vote and value of the stock of the corporation, or (2) the taxpayer owns at least 20 percent of the vote and value of the corporate stock, and at least 50 percent of the vote and value is owned by five or fewer corporate stockholders.

A special rule applies to bank or bank holding company stock. If the taxpayer owns at least 80 percent of the value of the stock of any bank or bank holding company, then for purposes of determining whether the taxpayer owns stock

possessing at least 50 percent of the vote (which is necessary to satisfy the test described in (1) above), the taxpayer is treated as owning any stock of such bank or bank holding company which the taxpayer has an option to acquire. For purposes of this special rule, the term "bank" has the same meaning as under Code section 581, and the term "bank holding company" means a bank holding company within the meaning of section 2(a) of the Bank Holding Company Act.

Redemption of stock in related corporations (Code sec. 304)

If a stockholder in one corporation transfers stock of that corporation to another corporation controlled by the same person or group of persons, and receives property including securities of the transferee, the transaction can be characterized under Code section 304 as a dividend rather than as a sale of stock.

An exception to the rule requiring dividend treatment applies to certain transactions in which stock of a bank is transferred to a bank holding company within the meaning of section 2(a) of the Bank Holding Company Act that is newly formed in connection with an acquisition of control of the bank. In such a case, certain minority stockholders of the bank holding company may transfer their bank stock to the bank holding company and receive securities of the bank holding company without dividend treatment. Rather, they generally are taxed on gain, if any, only to the extent the securities received.

Treatment of bank holding companies and their subsidiaries for purposes of the foreign tax credit limitation (Code sec. 864)

The United States taxes U.S. persons on their worldwide income, including their income from sources outside of the United States. The foreign tax credit generally allows U.S. taxpayers to reduce the U.S. tax on their foreign income by the foreign income taxes they pay on that income. The foreign tax credit for any year may not exceed the following amount, known as the foreign tax credit limitation: (1) pre-credit U.S. tax, multiplied by the quotient of (2) foreign source taxable income divided by (3) entire taxable income. Taxable income from foreign sources is computed by (a) determining the items of gross income that are from foreign sources, and then (b) subtracting from that amount of gross income that portion of the taxpayer's deductions that are allocable and apportionable to foreign source gross income.

With respect to the allocation and apportionment of deductions for interest expense of a U.S. corporate taxpayer, money generally is treated as fungible and interest expense is viewed as attributable to all business activities and property of the taxpayer and its affiliates. An exception to this

group-wide "one-taxpayer" rule is provided in the case of certain affiliates that are financial institutions. Under this exception, all members within the financial subgroup are treated as a separate single corporation for interest allocation purposes with respect to the interest expenses and assets of those members. The financial subgroup includes any member of the affiliated group that is a financial institution (described in Code sec. 581 or 591), the business of which is predominantly with persons other than related persons or their customers, and which is required by State or Federal law to be operated separately from any other entity which is not a financial institution (Code sec. 864(e)(5)(B) and (C)).

The financial subgroup also includes, to the extent provided in Treasury regulations, any bank holding company, and any subsidiary of a financial institution described in section 581 or 591 or of any bank holding company if that subsidiary is predominantly engaged (directly or indirectly) in the active conduct of a banking, financing, or similar business (Code sec. 864(e)(5)(D)). Current regulations provide that any direct or indirect subsidiary of a bank holding company that is predominantly engaged in the active conduct of a banking, financing, or similar business is considered a member of the financial subgroup for this purpose.

Possible Option

The possible option would amend H.R. 6, the Bank Reform Bill, to provide that the redesignation of the Bank Holding Company Act and cross references to that Act in Federal law would not apply for purposes of the Internal Revenue Code and any reference in the Internal Revenue Code to a bank holding company will include only those companies that engage in activities in which a bank holding company could engage in prior to enactment of the Bank Reform Bill. This amendment would not be in the form of an amendment to the Internal Revenue Code of 1986.

In addition, the possible option would delete the portion of the bill's required study relating to the tax treatment of savings associations.